

Message Text

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PAGE 01 SAN SA 04487 01 OF 02 010133Z

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ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W
----- 089322

O R 312146 OCT 75

FM AMEMBASSY SAN SALVADOR

TO SECSTATE WASHDC IMMEDIATE 9495

INFO AMEMBASSY GUATEMALA

AMEMBASSY TEGUCIGALPA

AMEMBASSY MANAGUA

AMEMBASSY SAN JOSE

C O N F I D E N T I A L SECTION 1 OF 2 SAN SALVADOR 4487

STADIS////////////////////////////////////

EXDIS

FOR KLEINE FROM MISSION DIRECTOR

ROCAP ALSO PASS USAID

E.O. 11652: GDS

TAGS: ECON, XM

SUBJECT: OMB BUDGET CUT FOR FY 77

REF: (A) STATE 253483 (B) SAN SALVADOR 4447

1. THE FOLLOWING MESSAGE IS AN ELABORATION OF SEVERAL OF THE
POINTS CONSIDERED IN REF B, AND IT HAS BEEN CLEARED BY THE
AMBASSADOR. WE SINCERELY REGRET THE UNAVOIDABLE DELAY IN
TRANSMISSION OF THIS MESSAGE AND HOPE THAT IT WILL STILL BE OF USE.

2. IN ADDITION TO POLITICAL AND RELATED CONSIDERATIONS
IN REF B, WE HAVE SEVERAL CONCERNS WITH THE TECHNIQUE
SUGGESTED IN REF A TO
DETERMINE ELIGIBILITY FOR FOREIGN ASSISTANCE: EITHER A REDUCED
AMOUNT OR A REDISTRIBUTION OF EXISTING FUND LEVELS. WE WOULD
THEREFORE LIKE TO REVIEW FIRST THE REASONS FOR OUR QUESTIONING
THIS TECHNIQUE, AND THEN
DISCUSS THE EFFECTS WE WOULD EXPECT FROM THE PRO-
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PAGE 02 SAN SA 04487 01 OF 02 010133Z

POSALS OUTLINED IN THE REFTTEL, AS WELL AS THE POLITICAL

REACTION WHICH IT MIGHT BRING.

3. WE CONSIDER ESTABLISHMENT OF A CEILING ON PERCAPITA GNP AS A MOST ARBITRARY AND IN MANY RESPECTS MEANINGLESS METHOD. TO BEGIN WITH, TIS ASSUMES THE STATISTICAL INFORMATION IS EQUALLY VALID OR INVALID IN EACH COUNTRY. SETTING SUCH A RULE WOULD BRING INTO PLAY IMMEDIATELY THE NEED TO RE-EXAMINE POPULATION STATISTICS AS WELL AS GROSS NATIONAL PRODUCT ESTIMATES. UNDOUBTEDLY, NEW HOUSEHOLD SURVEYS COULD BE PREPARED, BUT WE SUSPECT THAT SEVERAL QUICK SURVEYS IN ANY ONE COUNTRY WOULD SHOW WIDE VARIATIONS AND THUS PERMIT A CHOICE. THERE WOULD ALSO BE MEANINGLESS VARIATIONS BETWEEN COUNTRIES IN PART BECAUSE OF THE IMPOSSIBILITY OF ESTIMATING THAT PART OF INCOME WHICH NEVER ENTERS THE MONETARY SUSTEM.

4. ASIDE FROM THE VALIDITY OF THE STATISTICS, AS WELL AS THE QUESTION OF WHY WE SHOULD SET A CEILING OF \$300 RATHER THAN, SAY, \$350 OR \$325, OR ANY OTHER NUMBER THERE IS ALSO THE QUESTION OF THE EXCHANGE RATE. FOR EXAMPLE, AS A RESULT OF HIGH TARIFFS IN EL SALVADOR, THE EXCHANGE RATE IS OVER-VALUED. THEREFORE, WHILE \$300 IS THE EQUIVALENT OF 750 COLONES AT THE CURRENT FIXED RATE, WE SUSPECT THAT 750 COLONES MIGHT BE CLOSER TO, OR EVEN LESS THAN, \$250 WITHOUT SUCH RESTRICTIONS, BUT THERE WOULD BE NO WAY OF MAKING COMPARISONS BETWEEN COUNTRIES WITH ANY DEGREE OF ACCURACY SINCE THERE IS NO WAY OF DETERMINING THE EFFECTIVE RATE OF EXCHANGE. NEEDLESS TO SAY, PURCHASING POWER PARITY (MEASURE OF INCOME STANDARDS BETWEEN COUNTRIES) HAS NEVER BEEN SATISFACTORILY COMPUTED EVEN IN SUCH ADVANCED AREAS AS EUROPE.

5. THE SELECTION OF A PERCAPITA CEILING SAYS NOTHING WHAT-EVER ABOUT THE DISTRIBUTION OF INCOME. WHILE THE PRESENT ESTIMATE OF 1973 PERCAPITA INCOME IN EL SALVADOR IS IN THE AREA OF, REPEAT AREA OF, ABOUT 850 COLONES (WE ATTRIBUTE MUCH LESS ACCURACY TO THE ABSOLUTE LEVEL THAN TO ANNUAL CHANGES), SURVEYS DONE BY THE MINISTRY OF AGRICULTURE AND BY OTHERS, INCLUDING THE USAID, VARY WIDELY. ACCORDING TO ONE SURVEY MADE BY USAID WITH THE MINISTRY OF AGRICULTURE,, 5THE AVERAGE LEVEL IS ABOUT 250 COLONES IN ONE OF THE RURAL AREA: I.E. \$100 AT A 2.5 RATE OR LESS THAN \$85 AT A 3.0 RATE, ETC.IS IT THE PURPOSE OR INTENT OF THE CONGRESSIONAL MANDATE THAT WE HELP THE POOR ONLY IN THOSE COUNTRIES WHERE (AS FAR AS STATISTICAL AVERAGES ARE CONCERNED) THE RICH ARE NOT RICH
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PAGE 03 SAN SA 04487 01 OF 02 010133Z

ENOUGH TO OFF-SET THE AVERAGE INCOME OF THE MASS OF POVERTY-STRICKEN PEOPLE? WHILE WE ARE NOT WILLING TO DEFEND THE CONCEPT OF PROMOTING PROGRAMS ONLY IF THEY HAVE A DIRECT, REPEAT DIRECT, EFFECT ON THE POOREST, MOST OF OUR PROGRAMS ARE BEING AIMED AS DIRECTLY AS POSSIBLE AT THE POOREST IN THE NATION. IS THERE ANY DIFFERENCE BETWEEN A LARGE NUMBER OF PEOPLE EARNING, SAY, \$85 A YEAR PERCAPITA IN A COUNTRY WHICH HAS A NATIONAL AVERAGE PERCAPITA OF, SAY,

\$500, AND A SIMILAR NUMBER OF PEOPLE EARNING THAT SAME AMOUNT IN A COUNTRY WHICH HAS A NATIONAL AVERAGE OF, SAY, \$100? AS FAR AS THE MANDATES ARE CONCERNED, WE WOULD SAY DEFINITELY NOT; THE AIM IS TO HELP THE POOR (THE LOWER INCOME EARNERS), WHATEVER THEIR NATIONALITY. IF THE NATIONAL AVERAGE PER-CAPITA WAS, SAY \$5,000 OR EVEN \$3,000, ONE MIGHT, REPEAT MIGHT, ARGUE THAT THE COUNTRY CAN TAKE CARE OF ITS OWN PROBLEMS BY DOMESTIC TAX AND OTHER SUCH MEASURES, BUT WHEN THE AVERAGE IS \$350, \$500, OR \$600, DOES THAT ARGUMENT HOLD? WE HAVE STRONG DOUBTS.

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PAGE 01 SAN SA 04487 02 OF 02 011756Z

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TO SECSTATE WASHDC IMMEDIATE 9496

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AMEMBASSY MANAGUA

AMEMBASSY SAN JOSE

C O N F I D E N T I A L SECTION 2 OF 2 SAN SALVADOR 4487

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6. INDEED, EVEN IF WE HAD COMPLETELY ACCURATE STATISTICS IN ALL COUNTRIES, AND SIMILAR DISTORTIONS IN INCOME DISTRIBUTION, WE WOULD STILL CONSIDER THE AVERAGE PERCAPITA INCOME LEVEL TO BE A MOST INAPPROPRIATE TECHNIQUE TO DETERMINE WHICH COUNTRIES SHOULD BE GIVEN ASSISTANCE. IN A MORE POSITIVE SENSE, IF WE ARE INTERESTED IN IMPROVING CONDITIONS FOR THE POOR, WHY NOT CONCENTRATE ON THOSE COUNTRIES WHICH ARE MOST ABLE AND WILLING TO TAKE THE STEPS NECESSARY TO ACHIEVE RAPID GROWTH AND A BETTER INCOME DISTRIBUTION?

7. LEAVING ASIDE ALL OF THE ABOVE, THIS MISSION, AS MOST IF NOT ALL OTHER MISSIONS, HAS BEEN WORKING CLOSELY WITH THE

HOST GOVERNMENT TO PREPARE NEW PROGRAMS, SOME OF WHICH HAVE IMPLICATIONS THROUGH 1978. SOME GOES OFFICIALS HAVE EXPRESSED CONCERN AND DOUBT ABOUT PREPARING FOR THAT FAR AHEAD BECAUSE IT UTILIZES VERY SCARCE MANPOWER TO PREPARE PROGRAMS AND PROJECTS WHICH ARE ONLY POSSIBILITIES (NOT SURE THINGS), IN PART BECAUSE THEY DEPEND UPON THE AVAILABILITY OF FUNDS IN FUTURE YEARS. ARE WE NOW TO TELL THEM THAT BECAUSE THEIR PERCAPITA INCOME IS TOO HIGH (WHICH IS DIFFICULT SINCE, AS NOTED ABOVE, WE HAVE DOUBTS ABOUT THE ABSOLUTE VALUE OF THE GNP ESTIMATES AND WE BELIEVE THAT THE POPULATION LEVEL MAY BE CONFIDENTIAL

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PAGE 02 SAN SA 04487 02 OF 02 011756Z

SIGNIFICANTLY UNDERSTATED - ESTIMATES VARY BETWEEN 3.7 AND 4.2 MILLION) WE CANNOT DELIVER ANY NEW PROGRAMS IN FY 1977 OR AFTER?

8. NONE OF THIS IS MEANT TO SAY THAT THE COUNTRY WILL FALL APART IF WE DISCONTINUE ASSISTANCE; BECAUSE IT WILL NOT. A DISCONTINUATION OF ALL NEW AID PROGRAMS BEGINNING IN FY 1977 WOULD NOT HAVE ANY SERIOUS IMMEDIATE ECONOMIC EFFECTS SINCE WE ARE NOT PROVIDING ANY DIRECT BALANCE OF PAYMENT OR BUDGET SUPPORT, WHICH WHEN STOPPED WOULD CAUSE SERIOUS DISLOCATIONS. HOWEVER, IT WILL PROBABLY RESULT IN A LESS EFFECTIVE ECONOMIC AND SOCIAL DEVELOPMENT PROGRAM ESPECIALLY WITHOUT THE GRANT TECHNICAL ASSISTANCE WHICH AID PROVIDES IN CONJUNCTION WITH LOAN PROGRAMS AND THE MISSION ATTENTION TO THESE MATTERS; IFI LOANS ARE USUALLY NOT GIVEN THE SAME CLOSE SUPERVISION. HOWEVER, IT WILL CERTAINLY RAISE QUESTIONS ABOUT THE SINCERITY AND DEPENDABILITY OF THE US IN ITS STATED EFFORTS TO ASSIST THE LOWER INCOME GROUPS, AND AT THIS POINT WE ARE NOT SURE OF THE EXTENT TO WHICH OTHER DONORS WILL BE INTERESTED IN FINANCING THE KINDS OF PROGRAMS WE ARE NOW DEVELOPING WHICH MAY REQUIRE ASSISTANCE AFTER FY 76 (HEALTH, NUTRITION, AND EDUCATION) AS WELL AS THOSE IN FY 76 WHICH WILL PROBABLY REQUIRE FOLLOW-ON ASSISTANCE (LAND REFORM). WE ALSO HAVE A MORE PRESSING PROBLEM WITH REGARD TO SUPPORT OF THE AGRARIAN REFORM PROGRAM, SINCE WE ARE NOW AIMING FOR A FY 76 LOAN AGREEMENT WHICH, FOR TECHNICAL REASONS, MAY BE DELAYED TO FY 77, WHEN NO FURTHER ASSISTANCE WOULD BE PERMITTED ACCORDING TO THE PROPOSED FORMULA. AT THE LEAST, THIS WOULD BE EMBARRASSING AND IT WOULD LIKELY EXACERBATE ANY DISSATISFACTIONS WHICH THE NEW POLICY WOULD CAUSE. A LENGTHENING OF THE PHASE OUT PERIOD WOULD, OF COURSE, REDUCE OR ELIMINATE THIS PROBLEM.

9. IF THE PERCAPITA INCOME CEILING FAVORS ONE LA COUNTRY OVER ANOTHER, PARTICULARLY WITHIN REGIONAL GROUPINGS, IT WOULD PROBABLY RESULT IN SOME ADVERSE POLITICAL REACTION. HOWEVER, SINCE THE IMMEDIATE ECONOMIC IMPACT IS NOT LIKELY TO BE SEVERE IN EL SALVADOR, THE ADVERSE REACTION MAY BE LESS FORCEFUL, BUT ONLY IF THEY ARE ASSURED THAT BID AND/OR IBRD WILL FILL THE GAP, AND THEY PROBABLY WOULD MAKE AN ISSUE OF THIS. ON THE OTHER HAND, AS NOTED ABOVE, IF THE ISTA PROGRAM WAS CUT OUT AFTER ABOUT NINE MONTHS

OF NEGOTIATIONS, AND IF NO OTHER FINANCING WERE MADE AVAILABLE,
THE DISSATISFACTION WOULD BE MORE SEVERE. THE PERCAPITA INCOME
METHOD OF DETERMINING ELIGIBILITY WOULD CERTAINLY BE CRITICIZED;
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PAGE 03 SAN SA 04487 02 OF 02 011756Z

THEY HAVE LONG DISPUTED THEIR LD BANK METHOD FOR DETERMINING
INTEREST RATE PREFERENCES. IF THE PERCAPITA INCOME CEILING
RESULTS IN AN APPARENT US PREFERENCE FOR OTHER
AREAS OVER LA (THIS WOULD BE THE EFFECT OF THE OMB PROPOSAL),
IT WILL UNDOUBTEDLY RAISE POLITICAL QUESTIONS REGARDING OUR RELATIVE
INTERESTS IN LA AS AGAINST OTHER AREAS. AGAIN, WE SUSPECT
THAT THE ABOVE REASONING WOULD HOLD, BUT IN EITHER SITUATION
THE ASSURANCE THAT ONE OF THE INTERNATIONAL AGENCIES WILL
FILL-IN WOULD BE IMPORTANT.
IN SHORT, FOR EL SALVADOR, THE POLITICAL AND ECONOMIC FRICTIONS
WOULD BE MINIMIZED IF THERE IS AN ASSURANCE THAT IFI FUNDS WOULD
MAKE UP FOR AID WITHDRAWAL.

10. IN SUMMARY, WE CONSIDER THE AVERAGE PERCAPITA GNP TECHNIQUE
FOR DETERMINING ELIGIBILITY FOR AID ASSISTANCE TO BE INAPPROPRIATE
AND ILLOGICAL BECAUSE OF DEFINITION DIFFERENCES, STATISTICAL INACCUR-
ACIES, AND PROBLEMS OF PURCHASING POWER PARITY DUE TO EXCHANGE
RATE DIFFERENCES AND DIFFERING CONSUMPTION PREFERENCES IN EACH
COUNTRY. MOREOVER, IT DOES NOT ACCOUNT FOR DIFFERENCES IN
MANDATES OF GETTING TO THE POOR, WHATEVER THEIR NATIONALITY.
MOREOVER, IT IS A MEANINGLESS WAY TO DECIDE UPON INVESTMENTS
SINCE IT MAY VERY WELL RESULT IN LOWER RETURNS FOR US INVESTMENTS
IN FOREIGN ASSISTANCE. WE DO NOT THINK EL SALVADOR
WOULD BE CRIPPLED IN THE IMMEDIATE FUTURE IF WE
DISCONTINUED NEW PROJECT ASSISTANCE AFTER FY 77, AND WE DOUBT
THAT SERIOUS POLITICAL FRICTIONS WOULD PERSIST IF OTHER DONOR
ASSISTANCE OFFSETS OUR WITHDRAWAL
BUT WE SURE WOULD LOOK FOOLISH AND WE
CERTAINLY WOULD BE LEAVING THE "POOR" AS STRANDED
AS EVER AND WE WOULD BE DOING LESS TO ENCOURAGE
AND ACHIEVE THE OBJECTIVES OF THE CONGRESSIONAL
MANDATE; WE WOULD NO LONGER BE ABLE TO ASSURE DIRECT SUPPORT FOR
ONGOING-RUN DEVELOPMENT WHICH BENEFITS THE LOWER INCOME
EARNERS. NEEDLESS TO SAY THE VERY SHORT TIME FOR
PHASE OUT EXAGGERATES THE PROBLEM BECAUSE IT AFFECTS PROJECTS NOW
BEING NEGOTIATED.
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